

January 10, 2003

To: Supervisor Yvonne Brathwaite Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: David E. Janssen
Chief Administrative Officer

STATE UPDATE ON THE GOVERNOR'S FY 2003-04 PROPOSED BUDGET

Governor Davis released his Proposed Budget for FY 2003-04 which is intended to close a \$34.6 billion budget gap projected for the next eighteen months – the six months remaining in the current year, as well as the budget year. In addition, the Governor indicated that his proposal will address the structural budget deficit – the recurring gap between State spending requirements and the revenues available – which the Legislative Analyst (LAO) estimated in November to be \$12 billion to \$16 billion annually through FY 2007-08. In describing his proposal, the Governor stated his intent to “protect, to the extent possible, our progress in public education, public safety and children’s health insurance.”

The Governor’s estimate of the Budget shortfall is \$13.5 billion higher than the LAO’s November estimate and has been said by some (primarily the Republican Leadership) to be inflated. The LAO is scheduled to release its analysis of the Governor’s proposal in February, at which point there will be a non-partisan evaluation of the economic assumptions underlying the revenue forecast and the spending projections that determine the size of the Budget gap.

The Proposed Budget, if adopted, would have an immediate impact on the County by reducing State support in the current year, as well as in the budget year, by imposing new financial obligations in future years linked to uncertain new revenues. At a minimum, the Proposed Budget would reduce the County Vehicle License Fee backfill revenue by \$191 million in FY 2002-03 and \$472 million in FY 2003-04.

The Budget Gap

The \$34.6 billion gap is essentially unchanged from the number announced by the Governor in December. Over 50 percent of the amount - \$17.5 billion - is a result of lower revenue estimates for both the Budget year and prior years, with almost 70 percent of that amount in the personal income tax.

The other two components of the gap are the one-time measures used to balance last year's Budget that are not available in FY 2003-04 (36 percent) and higher spending estimates (13 percent). Some 30 percent of the gap is from changes in revenue and expenditure estimates for the current and prior years.

The Budget Solution

The Governor's Proposed Budget assumes adoption of the \$10.2 billion in reductions proposed in early December, as well as additional measures contained in the proposed Budget. Taken together, his solution would close the budget gap as follows:

- 59.9 percent (\$20.7 billion) through cuts and savings;
- 23.6 percent (\$8.3 billion) through tax increases to finance additional realignment;
- 6.1 percent (\$2.1 billion) from transfers and other revenues, including a yet to be negotiated revenue sharing agreement involving Indian gaming;
- 5.5 percent (\$1.9 billion) from fund shifts; and
- 4.9 percent (\$1.6 billion) from loans and borrowings, primarily involving the State Teachers' Retirement program.

The \$8.3 billion in new taxes include:

- \$4.58 billion from increasing the sales tax rate by 1 percent;
- \$2.58 billion from adding additional, higher income tax brackets to the personal income tax; and
- \$1.17 billion from increasing the excise tax on cigarettes and tobacco products by \$1.10 per pack.

Virtually all the new revenue (except for about \$100 million used to backfill revenue losses from the cigarette tax increase for Proposition 10, Proposition 99 and the Breast Cancer Fund) would flow to counties to support additional program responsibilities that would be shifted under a greatly expanded realignment of State and county functions. By dedicating the revenues to realignment, the Governor is able to avoid the Proposition 98 requirement that half or more of new State revenue flow to education. Otherwise, to achieve the same reduction in the budget gap would require a tax increase over twice the size of what is proposed.

Impact on Counties

In addition to numerous specific and largely incremental reductions to counties in the \$20.7 billion of cuts and savings, two major policy proposals will dramatically impact counties and fundamentally change the State-County relationship.

Vehicle License Fee (VLF) Backfill

The Governor has proposed to no longer fund the general government portion of the VLF backfill starting in February 2003. (The realignment related portion of the backfill would not be impacted.) This would result in a savings to the State of \$1.3 billion in the current year and \$2.9 billion in the Budget Year. While cities and counties would contribute to these savings, the impact would amount to an almost 5½ percent reduction in total revenue to counties and 4 percent to cities. The impact on Los Angeles County would be major, resulting in a loss of approximately \$191 million in the current year and \$472 million in FY 2003-04. On an annualized basis, this amounts to over 30 percent of the County's discretionary revenue, approximately half of which is used to finance health and public protection functions.

State-Local Program Realignment

The Governor has proposed a dramatic expansion of the realignment of State and Local programs initiated in 1991 by transferring over 30 programs and \$8.2 billion of costs/revenues to counties. The program areas affected include Mental Health and Substance Abuse, Children and Youth, Health and Social Services, Long-Term Care and Court Security. (Please see the attachment for a list of programs transferred.) It appears that in most cases 100 percent of the non-Federal share of the program costs would be shifted to counties.

The four largest programs transferred – Medi-Cal benefits (15 percent County share), Medi-Cal Long-Term Care, In-Home Supportive Services and Child Care – account for over 62 percent of the costs shifted to counties. And two others, Child Welfare Services and Foster Care Grants account for another 12.7 percent. Aside from the Budget

numbers reflecting the shift, program details are lacking. The Administration has indicated that the details will need to be negotiated in the legislative process and, assuming enactment, during the first year of implementation.

While the County has generally been supportive of the previous realignment and is not opposed in principle to additional program realignment, there are reasons for concern about the Governor's proposal. Many of the programs to be transferred, especially the four largest, are fast growing programs that will expand even faster with the aging of the baby boomers. With the exception of the tobacco revenues, the new revenues are sensitive to the overall economy and it is unlikely that they will keep pace with program growth. Many of the programs to be transferred are Federal entitlement programs or State mandated programs for which counties have little or no authority over eligibility or benefit levels, leaving counties with the responsibility of paying for programs that they cannot control. The proposal does not specify a method to allocate the new revenues, and because the rate of growth for these programs is likely to vary considerably between counties, a mechanism will need to be developed to reallocate revenues to reflect changing caseloads.

Budget Highlights

Based on a preliminary analysis of the "Governor's Budget Highlights," the following proposals are most likely to impact or be of interest to the County.

General Government

SB 90 Reimbursement. The Governor proposes to continue the deferral of local government reimbursement for State mandates indefinitely which will result in a net cost to the County of approximately \$40 million in FY 2003-04, on top of a \$42 million deferral for the current and prior years.

Federal Child Support Penalty. The Governor proposes to assess counties 25 percent of the cost of the Federal penalty - \$207 million - imposed because the State's automated system continues to be out of compliance with Federal requirements. The assessment would be collected starting in the last quarter of the current year.

Community Redevelopment Authority Transfer. The proposed transfer of unencumbered funds in the low and moderate income housing account to the State will cost the Community Development Commission around \$800,000 and possibly more, depending on the definition of unencumbered.

Workers' Compensation User Fee. The Governor proposes to shift the cost of administering the system entirely to users, instead of the 20 percent they currently pay, which will result in a 500 percent increase that will cost the County \$1.7 million.

Public Library. Reimbursement for direct and interlibrary loans has been eliminated.

Lancaster Armory. The Governor has provided funding to complete the Armory.

Health

DSH Administration Fee. No increase is proposed beyond the current \$85 million.

Medi-Cal Eligibility. The FY 2003-04 Budget includes \$4.3 million (\$2.1 million General Fund) to link Medi-Cal eligibility with free school lunch eligibility, \$8.5 million (\$4.2 million General Fund) to link Medi-Cal eligibility with the Food Stamp Program to cover an additional 11,000 parents and children, and a total of \$486.6 million (\$243.3 million General Fund) to provide continuous Medi-Cal eligibility for an estimated 471,500 children. The Budget proposes to increase the Medi-Cal share of cost for aged and disabled beneficiaries, and eliminate a second year of transitional Medi-Cal for persons leaving CalWORKs.

CHDP Program Reform. The Budget reduces funding by \$80.6 million for the Child Health and Disability Prevention Program (CHDP), which provides childhood screening and immunizations to low-income children. However, it includes \$283.9 million (\$137.1 million General Fund) to use CHDP as a gateway to streamline enrollment into Medi-Cal or the Healthy Families Program. Pre-enrolled children will be immediately eligible, for up to two months, for a CHDP health assessment and for comprehensive medical care provided through Medi-Cal or the Healthy Families Program.

Healthy Families Parent Expansion. The Governor proposes to defer parent eligibility until July 2006.

Trauma Care. The Governor's Budget does not affect funding of \$20 million in the current year, but does not include funding in the Budget year.

Medi-Cal Optional Benefits. The proposed Budget would eliminate the following ten Medi-Cal optional benefits: (1) hospice; (2) non-emergency medical transportation; (3) optometry; (4) optician/lab services; (5) physical therapy; (6) prosthetics; (7) orthotics; (8) speech/audiology; (9) hearing aids; and (10) durable medical equipment. These are in addition to the eight benefits which were proposed for elimination in December 2002: (1) adult dental services; (2) medical supplies; (3) podiatry; (4) acupuncture; (5) chiropractic services; (6) psychology; (7) Independent

Rehabilitation Centers; and (8) occupational therapy. However, these benefits would still be provided to children under 21 years of age and beneficiaries in long-term care services.

Provider Rate Reductions. The Budget proposes to reduce medical provider payments by 5 percent, in addition to the 10 percent rate reduction proposed by the Governor in December 2002. Hospitals and Federally Qualified Health Centers are not subject to the reductions.

HIV/AIDS Co-payments. The Governor's Budget proposes to impose a drug co-payment on recipients of the AIDS Drug Assistance Program (ADAP) with incomes between 200 percent and 400 percent of the Federal poverty level. Recipients with incomes between \$21,643 and \$30,233 will pay approximately \$1,299 to \$1,814 annually for the drugs provided by ADAP.

Mental Health

Local Mental Health Plans. The Budget includes an increase of \$34 million (\$17 million General Fund) for local mental health plans to reflect caseload growth and ensure compliance with new Federal regulations governing operation of the Medicaid managed care program.

Early and Periodic Screening, Diagnosis, and Treatment services. The Governor proposes a \$230.4 million increase in reimbursements for these services.

Social Services

Child Care. The Budget proposes to eliminate CalWORKs Stage 3 child care services effective April 1, 2003. The Budget also proposes to include child care in realignment by transferring responsibility for child care and development programs administered by the State Department of Education to counties, with the exception of State Preschool and the After School Education and Safety Programs. It is not clear if county government or county departments of education will be responsible for child care.

CalWORKs Grants. The Budget proposes to reduce CalWORKs cash grants by approximately 6 percent from the level in the FY 2002 Budget Act and does not provide for a cost-of-living adjustment. This will result in \$496.4 million in savings in FY 2003-04 and allows \$65.7 million in TANF funds to be transferred to the Federal Title XX Block Grant in order to offset General Fund costs within the Department of Developmental Services.

CalWORKs Employment Services. The Budget provides a one-time augmentation in the current year of \$241.5 million for employment services.

CalWORKs Administration. The Budget includes \$386.4 million in FY 2003-04 for CalWORKs Administration, which is \$35.1 million less than in FY 2002-03.

CalWORKs Performance Incentives. No funds are budgeted for Performance Incentives for FY 2003-04 but an adjustment was made to increase the County Performance Incentives paid in FY 2002-03 by \$82.4 million.

CalWORKs Substance Abuse and Mental Health Services. Substance Abuse Services and Mental Health Services are maintained at a combined total of \$119.9 million which is the same as the FY 2002-03 appropriation.

SSI/SSP. The Governor proposes \$2.3 billion General Fund for the SSI/SSP program in FY 2003-04, which represents a 24.2 percent overall reduction. In addition, the Budget proposes to suspend the June 2003 and January 2004 State COLAs (3.74 percent and 3.48 percent, respectively) and reduce the SSI/SSP grant to the Federally-required MOE level, effective July 1, 2003.

Adoptions. The Governor proposes legislation to eliminate the Independent Adoption Program in 2003-04 for a General Fund savings of \$2.8 million. However, the Budget does include \$65.1 million (\$34 million General Fund) for the Relinquishment Adoptions Programs to facilitate the adoption of children in foster care.

Transitional Housing for Foster Youth. The Budget includes new funding of \$1.4 million to provide transitional housing placement services to emancipated foster youth.

Los Angeles Eligibility, Automated, Determination, Evaluation, and Reporting (LEADER) System. The Budget includes \$26.8 million (\$9.7 million General Fund) for maintenance and operation of this system. This represents an increase of \$7.9 million (\$2.9 million General Fund) above the 2002 Budget Act.

Child Welfare Services/Case Management System (CWS/CMS). The Budget includes \$121 million (\$60 million General Fund) for contract-related costs for system maintenance and operations. Overall, proposed CWS/CMS maintenance and operations funding for FY 2003-04 is \$38.1 million (\$19.1 million General Fund) above the 2002 Budget Act. The Budget also includes an increase of \$5.3 million (\$2.7 million General Fund) to proceed with activities necessary to design, develop, and implement the expanded adoptions subsystem for the CWS/CMS to meet Federal guidelines.

Statewide Fingerprint Imaging System (SFIS). The Budget includes \$10 million General Fund for maintenance and operations activities, which represents a reduction of \$731,000 in the current and Budget years, due to the shift of system operation costs to counties.

Electronic Benefit Transfer (EBT). The Budget includes \$61 million (\$19.2 General Fund) to continue Statewide implementation, which represents an increase of \$4.2 million (\$161,000 General Fund) above the FY 2002 Budget Act. Federal law requires states to implement an EBT system to deliver food stamps benefits by October 1, 2002. However, California has received a 41-month extension.

Resources and Environmental Protection

Natural Resources. The Budget emphasizes the use of Proposition 40 and 50 funding, without providing specific project details. The County will be able to seek grant funding for projects from a variety of programs. The Budget proposes \$1.1 billion from Proposition 50 for the protection of water resources, including \$515 million for grants for acquisition and restoration of sensitive lands, such as the Ballona Wetlands. River Parkways will receive \$25 million from Proposition 50 and \$7.9 million from Proposition 40, with priority given to local projects that improve water quality, promote watershed protection, and increase recreation opportunities. From Proposition 40, there is an additional \$594.2 million for local grants to restore park facilities, of which \$125.6 million is for historical and cultural projects. The Budget also provides \$582.1 million from bond funds and other sources for the CalFed Program, which could provide grants for local water conservation, desalination, environmental restoration, and dam security projects.

Environmental Protection. The Budget proposes shifting \$10 million in costs for air quality programs from the General Fund by increasing stationary source fees. Similarly, \$13.6 million in water quality program costs are shifted by increasing waste discharge fees levied against local entities for storm water discharge permits. Integrated Waste Management programs are increased by approximately \$3.8 million, all funded from the Integrated Waste Management Account.

Justice

Juvenile Crime Prevention Program. The program is fully funded.

TANF Funding for Juvenile Probation. The program is fully funded.

The California Youth Authority Fee. The sliding fee charged for youthful offenders committed by counties is increased by \$7.1 million as a result of an inflation adjustment.

Community Law Enforcement and Recovery Program (CLEAR). The program is not funded.

Domestic Violence Programs. The Office of Criminal Justice Planning (OCJP) funding is reduced by \$9.5 million, because local assistance funding of domestic violence programs is consolidated into the Department of Health Services. In addition, some OCJP grants potentially impacting the Sheriff, District Attorney and Public Defender, were included in a \$3.8 million reduction proposed in December.

Local Assistance for Standards and Training. The Budget eliminates \$16.8 million in local assistance for correctional officers which may impact the Probation and Sheriff's Departments. The portion currently paid by the State will now become the responsibility of local correctional agencies.

Transportation

Local Street and Road Fund. The Governor eliminated \$90 million in payments in the current year to solve a cash flow problem in the State Highway Account. Public Works estimates it would have received \$12.6 million of that amount, and will lose another \$18 million if the cash flow problem continues in the Budget year.

Judicial

State Trial Court funding. The Budget assumes a security fee of \$20 per court filing and a \$10 increase in the trial motion fee, as well as the transfer of \$31 million in annual revenue from undesignated fees on court-related activities from the counties to the courts.

We will continue to keep you advised.

DEJ:GK
MAL:JR:ib

Attachment

c: Executive Officer, Board of Supervisors
 County Counsel
 Local 660
 All Department Heads
 Legislative Strategist
 Coalition of County Unions

State-Local Realignment
(Dollars in Millions)

Department	Program	GF Savings	Cost to Counties
Mental Health and Substance Abuse			
DADP	Local Programs	\$ 219	\$219
DADP	Drug Courts/State Operations	12	11
DMH	Children’s System of Care/State Ops	20	20
DMH	Integrated Services for Homeless/ State Operations	55	55
	Mental Health & Sub. Abuse Total	306	305
Children and Youth			
DSS	Child Abuse Prevention/Intervention and Treatment	13	13
DSS	Foster Care Grants	460	460
DSS	Foster Care Administration	34	34
DSS	Child Welfare Services	596	596
DSS	Adoption Assistance	217	217
DSS	Kin Gap	19	19
SDE	Child Care	968	1,031
	Children and Youth Total	\$2,307	\$2,370
Healthy Communities			
DHS	15 Percent County Share of Medi-Cal Benefits Costs	\$1,620	\$1,620
DHS	Adolescent Family Life Program	14	14
DHS	Black Infant Health Program	4	4
DHS	Local Health Dept. Maternal & Child Health (MCH)	3	3
DHS	Expanded Access to Primary Care (EAPC)	24	24
DHS	Indian Health Program (HP)	7	7
DHS	Rural Health Services Dev. Program (RHSD) and Grants in Aid (GIA) for Clinics Program	9	9
DHS	Seasonal Ag. & Migratory Workers (SAMW) Program	7	7
DHS	Managed Care Counties		(0.9)
DHS	CA Health Care for Indigents (CHIP)		(46.2)
DHS	Rural Health Services		(4.4)
DHS	County Health Serv. Pub. Health Sub.	1	1
DHS	Reductions to Rural Health Care and MCH State Operations	2	
DSS	Cash Assistance Programs for Immigrants	95	95
DepartmentProgramGF SavingsCost to Counties			
DSS	Adult Protective Services	61	61
DSS	California Food Assistance Program	15	15
DSS	Food Stamp Administration	268	268
DSS	Cal Works Administration	120	120
DSS	Cal Works Employment Services	423	423
	Cost of Prop 99-funded Programs		58
	Healthy Communities Total	\$2,671	\$2,727
Long Term Care			
DHS	Realign Medi-Cal Long-Term Care	\$1,400	\$1,400
DSS	In-Home Supportive Services	1,086	1,086
DSS	In-Home Supportive Services Adm.	85	85
	Long Term Care Total	\$2,571	\$2,571
Court Security			
Trial Courts	Court Security	\$ 300	\$ 300
	TOTAL REALIGNMENT	\$8,154	\$8,273